STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

South Beloit Water, Gas and Electric Company	:	
	:	**03-0676**
Proposed general increase in natural gas rates. (Tariffs filed October 10, 2003)	:	**(Cons.)**
	:	
South Beloit Water, Gas and Electric Company	:	
	:	**03-0677**
Proposed general increase in water rates. (Tariffs filed October 15, 2003)	:	

DRAFT ORDER

TABLE OF CONTENTS

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

South Beloit Water, Gas and Electric Company	:	
	:	**03-0676**
Proposed general increase in natural gas rates. (Tariffs filed October 10, 2003)	:	**(Cons.)**
	:	
South Beloit Water, Gas and Electric Company	:	
	:	**03-0677**
Proposed general increase in water rates. (Tariffs filed October 15, 2003)	:	

DRAFT ORDER

By the Commission:

I. Background

A. Procedural History

On October 11, 2003, South Beloit Water, Gas and Electric Company ("SBWGE" or "the Company") filed with the Illinois Commerce Commission ("Commission") revised tariff sheets[1] proposing general increases in rates for natural gas services and changes in certain terms and conditions. The revised tariff sheets were to become effective January 1, 2004. On October 15, 2003, the

[1] The revised tariff sheets submitted for natural gas are Tariff No. 11; Original Sheets No. 1, Original Sheets Nos. 2, 2.1, Original Sheets No. 3, Original Sheets Nos. 4, 4.1, Original Sheets Nos. 5, 5.1, 5.2, 5.3, 5.4, 5.5, Original Sheets Nos. 6, 6.1, 6.2, 6.3, 6.4, 6.5, 6.6, 6.7, Original Sheets Nos7, 7.1, Original Sheets Nos. 8, 8.1, 8.2, Original Sheets Nos. 9, 9.1, 9.2, 9.3, Original Sheets Nos. 10, 10.1, 10.2, 10.3, Original Sheets Nos. 11, 11.1, Original Sheets Nos. 12-13, Original Sheets Nos14, 14.1, 14.2, 14.3, 14.4, 14.5, 14.6, 14.7, 14.8, Original Sheets Nos. 15, 15.1, 15.2, 15.3, 15.4, 15.5, 15.6, 15.7, 15.8

Company filed with the Commission revised tariff sheets[2] proposing general increases in rates for water services and changes in certain terms and conditions. The revised tariff sheets were to become effective January 1, 2004.

In accordance with the requirements of Section 9-201(a) of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq., and 83 Ill. Adm. Code 255, notices of SBWGE's filings with the Commission were timely published twice in newspapers of general circulation throughout SBWGE's gas and water service territories. The first notice was published within ten days of the filings. The second notice was published within one week of the first notice. SBWGE indicates further that a copy of a public notice was posted and a copy of the filing with the Commission was made available for public inspection at its Rockton, Illinois office.

On November 5, 2003, the Commission entered orders suspending the revised tariff sheets for both natural gas and water rates until April 14, 2004. The investigations into SBWGE's rate case filing initiated by the November 5, 2004, Suspension Orders are identified as Dockets 03-0676 and 03-0677. On April 7, 2004, the Commission entered Resuspension Orders in both dockets extending the suspension of the proposed tariff sheets until October 14, 2004.

Pursuant to due notice, a status hearing was held in these matters before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois on November 25, 2003. At this hearing, the two dockets were consolidated and a procedural schedule was established. Following extensive discovery and the submission of prepared direct testimony, evidentiary hearings

[2] The revised tariff sheets submitted for water are Tariff No. 8, Original Sheets Nos. 1-11, Original Sheets Nos. 12, 12.1, Ill. C.C. No. 7 Revised Sheet No. 6, Canceling 2nd Revised Sheet No. 6, Ill.C.C. No. 7, First Revised Information Sheet No. 1, Ill.C.C No. 7, First Revised Information Sheet Nos. 30-33.

were held at the Commission's Springfield offices on May 19, 2004. Testimony from SBWGE and Staff were admitted into the record. At the conclusion of the hearing on May 19, the record was marked "heard and taken." SBWGE and Staff each submitted an Initial Brief and Reply Brief. A proposed Order was served on the parties. Briefs on Exceptions and Replies were received and duly considered.

B. Nature of Operations

SBWGE is a utility company operating only within the state of Illinois and provides retail electric, gas and water utility service in and around the City of South Beloit, Illinois. SBWGE provides natural gas distribution service to approximately 6,800 residential, commercial and industrial customers in nine communities in northern Illinois including the City of South Beloit and surrounding parts of Winnebago County, Illinois and small sections of Stephenson County, Illinois. SBWGE also provides water service to approximately 2,000 residential, commercial and industrial customers in nine communities in northern Illinois including the City of South Beloit and surrounding parts of Winnebago County, Illinois.

The City of South Beloit immediately adjoins the City of Beloit, Wisconsin, separated only by the state line running down the center of a paved street. The City of Beloit, Wisconsin is served by WPL. Residences and business establishments on the Illinois side and Wisconsin side receive gas service from an integrated gas distribution pipes connected to and supplied through a single gas main running along that street. WPL and SBWGE have contiguous service territories, with natural gas service provided by WPL on the Wisconsin side and

SBWGE on the Illinois side. Gas service is not metered at locations where it crosses the state line. Meters measure gas service as it is delivered to the customers or used by the utility.

Similarly, SBWGE provides its water service from pipes connected to and supplied through a single integrated water distribution system with WPL, the Wisconsin portion of which was wholly owned by WPL during the test year, but most of which is now owned by the City of Beloit, Wisconsin. The water distribution systems of the respective entities are connected at several points along the state borderline. Water service is not metered at locations where it crosses the state line. Meters measure water service as it is delivered to the customers or used by the utility. SBWGE has a limited amount of water production facilities and until recently, WPL has supplied SBWGE with water supply. In December, 2003, WPL sold its water production facilities to the City of Beloit. While WPL provides SBWGE with all services necessary to maintain and operate its water operations, the City of Beloit now provides SBWGE with its water supply.

SBWGE has no employees. All administrative and operational functions of SBWGE are provided by employees or contractors of WPL. In addition to natural gas, the Company receives from WPL certain other services necessary to operate gas utility business. The conditions of these services are established in a contract between SBWGE and WPL (Gas Contract) approved by the ICC in Docket No. 97-0088. SBWGE also receives certain other services from WPL that are necessary to operate a water utility business. The conditions of these services are established in a contract between SBWGE and WPL recently approved by the Commission in Docket No. 03-0462.

C. Reasons for Increase

The last rate increase for SBWGE's water operations was approximately $96,040 granted by the Commission's Order in Docket No. 85-0505 issued on September 17, 1986. SBWGE's last rate increase for its gas operations was $416,000 granted by the Commission in Docket No. 83-0577, on September 18, 1984.

SBWGE now proposes to increase its annual gas operating revenues by $560,490, an increase of about 24.1%, and increase its annual water operating revenues by $755,002, which includes the rate impacts for the requested rider for the water surcharge,[3] an increase of about 164.4%. SBWGE states that increasing costs to operate its gas and water businesses coupled with the increasing levels of investment in the gas and water utility property have caused SBWGE's rate of return on its gas business to deteriorate to 3.68% for the gas operations and to -1.95% its water operations for the twelve moths ending December 31, 2002. Since its last rate case, SBWGE experienced a change in the source of its water supply, and is requesting for authorization to implement a purchased water surcharge.[4] The test year that SBWGE seeks to use is the twelve month period ending on December 31, 2002, as adjusted with pro forma adjustments for known and measurable changes. No party opposed the use of this period, the use of which the Commission approves.

[3] SBWGE has received its water supply from its parent, WPL, until WPL sold its water production facilities to the City of Beloit (the Sale). As a result of the Sale, WPL will no longer have available to it the water production facilities which have traditionally provided SBWGE with water supply. Those water production facilities now are owned by the City of Beloit.

[4] SBWGE now purchases water supply from the City of Beloit. The Company therefore has requested a water surcharge to recover water supply costs.

II. Rate Base

A. Introduction

The rate base represents the net level of investment that a utility company has dedicated to public service on which that the company is entitled to earn a return. The rate base consists of net book investment in plant and working capital, less deductions to reflect other sources of funds, such as deferred taxes.

Schedules showing SBWGE's gas and water operations at present and recommended rates for the test year ending December 31, 2002, were presented by SBWGE and Staff witnesses. During the course of this proceeding SBWGE made certain adjustments proposed by Staff. SBWGE's adjusted original cost rate base proposed for its gas operations is as follows:

1	Plant in Service for Gas Operations	$12,977,388
2	Depreciation Reserve	(6,647,680)
3	**Net Plant**	6,329,708
4		
5	**Additions to Rate Base**	
6	Construction Work in Progress without AFUDC	122,893
7	Materials and Supplies & Other Investments	557,591
8	Working Capital Allowance	178,825
9	Total Additions	859,309
10		
11	**Deductions from Rate Base**	
12	Accumulated Deferred Income Taxes	(830,165)
13	Customer Deposits	-
14	Customer Advance for Construction	(68,258)
15	Total Deductions	898,423
16		
17	**Rate Base**	6,290,594

SBWGE's recommended rate base for water operations, which includes Staff's adjustments, is as follows:

1	Plant in Service for Water Operations	$6,243,258
2	Depreciation Reserve	(917,195)
3	**Net Plant**	5,326,063
4		
5	**Additions to Rate Base**	
6	Construction Work in Progress without AFUDC	415
7	Materials and Supplies & Other Investments	-
8	Working Capital Allowance	23,869
9	Allocation of Rate Base – WPL Contract	-
10	Total Additions	24,284
11		
12	**Deductions from Rate Base**	
13	Accumulated Deferred Income Taxes	(23,828)
14	Customer Advance for Construction	(1,316,179)
15	Customer Deposits	(11,687)
15	Total Deductions	1,351,694
16		
17	**Rate Base**	3,998,653

B. Uncontested Issues

SBWGE adopted all of Staff's adjustments to rate base for both the gas and water operations. Staff Witness Ms. Bonita A. Pearce made adjustments to the Gas Rate Base as outlined in ICC Staff Exhibit 1.0, Schedule 1.3 Gas. Those adjustments are to Depreciation and Amortization, Material, Supplies and Other Inventories, and Cash Working Capital. Staff Witness Pearce also made adjustments to the Water Rate Base as outlined in ICC Staff Exhibit 1.0, Schedule 1.3 Water. In that schedule, she made adjustments for Cash Working Capital and Customer Deposits.

C. Contested Issues

1. Gas Services Contract between SBWGE and its parent, WPL

a. The Gas Contract

On February 3, 1997 SBWGE filed a petition requesting the Commission for authorization to modify the natural gas service contract between, SBWGE and its parent, WPL. WPL is SBWGE's sole supplier of metered natural gas service under the terms of a contract for natural gas that was previously approved and used by the Commission in the last base gas rate case. The Commission approved the modified contract in ICC Docket Number 97-0088, June 11, 1997. In that proceeding, Staff reviewed the Gas Contract and the late filed Exhibit 4, and did not object or recommend any modifications to the amended Gas Contract.

b. Staff's Position

Staff recommends that the Commission order SBWGE to file a petition requesting Commission approval of a new gas contract between SBWGE and WPL within six months of the order date in this proceeding. The reason for Staff's recommendation is that the methodology utilized in the current gas contract effectively replaces all direct costs incurred by SBWGE with a percentage allocation of WPL's total costs.

Staff noted that SBWGE has a similar contract with WPL for its water operations that was approved by the Commission in Docket No. 03-0462 on March 17, 2004. In the new contract, the method by which SBWGE is allocated costs for the water services it receives from WPL is changed. The new methodology reflects all direct costs incurred by SBWGE plus an allocation for certain incremental indirect costs from WPL.

It is Staff's contention that the allocation methodology contained in the new water contract services is superior to the allocation methodology reflected in the current gas contract because it reflects the actual costs directly incurred by SBWGE along with a proportion of allocated costs from WPL. Staff asserts that the methodology utilized in the current gas contract effectively replaces all direct costs incurred by SBWGE with a percentage allocation of WPL's total costs. This is apparent from review of Formulas 2 through 5 of the existing gas contract.

Staff also believes this methodology is evident from the allocation of rate base to SBWGE, as detailed on Schedules B-1 and B-6 attached to the direct testimony of SBWGE witness Martin W. Seitz (SBWGE Exhibit MSW-1 (Gas) Schedules B-1 and B-6).

Staff contends Schedule B-6 derives the average rate bases for WPL and SBWGE, respectively, and adds the two averages to derive a combined average rate base. The allocation factor is applied to the combined average to derive the total allocation to SBWGE. From that amount the direct SBWGE rate base is deducted to derive the allocation rate base to SBWGE as calculated by the existing Gas Contract. This amount is then added back to the direct SBWGE rate base on Schedule B-1. The theoretical effect of this methodology is that the allocation under the existing Gas Contract acts as a plug amount to get the direct SBWGE amount back to the allocated total that was derived on Schedule B-6. The only difference between the total rate base in Schedule B-1, column (D), and Schedule B-6, column (H) is due to the fact Schedule B-6 uses average balances instead of the year end balance that appears on Schedule B-1. Given that the current methodology produces costs based on estimated allocations, Staff asserts that actual cost information would be superior to the extent it is available.

While Staff agrees with SBWGE that the direct costs incurred by SBWGE remain on its books, Staff contends that the effect of the allocation methodology used by SBWGE is that regardless of the amount of the direct costs on SBWGE's books, the final amounts on SBWGE's books will reflect the allocation of the combined SBWGE and WPL costs, thereby effectively replacing the direct costs with an allocation.

Staff maintains that changing the methodology will reflect, to the extent possible, the actual costs incurred to provide service. Staff argues assigning costs directly to SBWGE, with allocations only for indirect/un-assignable costs that are necessary to provide gas service to SBWGE customers, would accomplish this objective.

c. SBWGE's Position

SBWGE contends that the Staff has not established that the current Gas Contract approved by the Commission is unreasonable. SBWGE contends Staff is oversimplifying the process, and that the Gas Contract and the new Water Services Contract are not comparable. The existing Gas Contract covers an integrated gas distribution system comprising the Beloit, Wisconsin area and the SBWGE service area. By contrast, the Water Services Contract does not cover an integrated system where the parent company is supplying the source of the service, i.e. water.

SBWGE explained that WPL has historically provided all of the water and natural gas, as well as supporting operations, for SBWGE. These water and natural gas operations, however, are distinct utilities on the system and the same conditions and principles will not always pertain to each of them. Each utility service provided by WPL to SBWGE is governed by separate contractual arrangements, and those contractual arrangements vary or remain the same depending upon business conditions and other situations. The circumstances that gave rise to the need to seek approval of a new water contract do not exist for the gas utility. The old water contract needed revisions because part of the resources previously provided by WPL to SBWGE could no longer be provided by WPL after WPL sold its water utility facilities to the City of Beloit, Wisconsin.

This is not the case with the gas utility. WPL still owns the gas facilities in the Beloit Wisconsin area and together with the gas facilities in the SBWGE area, the facilities represent an integrated system that is operated to the benefit of the customers served.

All the physical gas utility assets located in Illinois are owned by SBWGE and are recorded on the books and records of SBWGE. These assets have not been replaced by an allocation; the costs are directly assigned to SBWGE. Staff does not take into consideration that SBWGE may rely on assets owned by WPL and located in Wisconsin, such as gas gate stations that interconnect with natural gas pipeline suppliers, common equipment, such as computer equipment, and gas storage costs. Indeed, Formula 1.1-1.3 explain that the gas supply is delivered to the Wisconsin Company at its interconnections with ANR Pipeline and Northern Natural Gas Company. (ICC Staff Cross Exhibit 2 - Seitz). The approved formulas incorporated into the existing contract determine what portion of the gas or common utility assets owned by WPL and located in Wisconsin are necessary to serve SBWGE, and then allocate only that increment in accordance with the Gas Contract.

SBWGE depends on its parent, WPL, for many services it cannot provide, and the only reasonable methodology is to look at the facilities and the costs that are being provided and allocate those incremental costs in a manner consistent with the manner in which those assets are being utilized. The current Gas Contract first assigns direct costs to SBWGE and then allocates only incremental costs on assets owned by WPL and located in Wisconsin all in accordance with the approved formulas in the Gas Contract. WPL and SBWGE believe this method is reasonable and the reasonableness of the Gas Contract was the basis for Commission approval in 1997. Circumstances have not changed since 1997 that would require a change in the Gas Contract.

SBWGE believes that the methodology in the Gas Contract is reasonable. Indeed, the Commission found the Gas Contract and its predecessor to be reasonable in ICC Docket Number 97-0088 and in ICC Docket Number 84-0466. Staff has made no attempt to demonstrate that current methodology is unreasonable, other than to say that actual cost information "is superior to the extent it is available." SBWGE, however, notes that Staff offers no specific changes to the Gas Contract to demonstrate what changes would make an amended contract "superior" to the existing Gas Contract. Moreover, Staff does not give any statutory basis on which the Commission can rely on in order to direct SBWGE to file a petition for Commission approval of a new gas contract. Consequently, the Commission should reject Staff's proposal because Staff's proposal goes beyond the scope of the Public Utilities Act (PUA) and Staff does not establish the current Contract is unreasonable.

d. Commission Conclusion

The Commission is not convinced that requiring SBWGE to file a new gas contract would create a more reasonable contract than the one that is currently in place. The Commission found that Gas Contract to be reasonable in Docket No. 97-0088, and the Commission notes that nothing has changed in SBWGE's operations that would justify a new change now.

The Commission finds that current Gas Contract allows direct costs and rate base components that are directly assignable to SBWGE to remain on its financial records. SBWGE is unique in that it depends on some assets of its parent, WPL, and some of those assets are owned by WPL and located in the State of Wisconsin. The Commission agrees with SBWGE that the only reasonable methodology is to look at the facilities and the costs that are being provided and allocate those incremental costs in a manner consistent with the manner in which those assets are being utilized. Thus, the Commission will decline to adopt Staff's recommendation that SBWGE file a new gas contract within six months of this order.

D. Commission Conclusion on Original Cost Rate Base

Giving effect to the adjustments to rate base as adopted by the SBWGE and Staff, the Commission concludes that SBWGE's original cost rate base for its gas operations in the test year is $6,290,594, and that SBWGE's original cost rate base for its water operations is $3,998,653. These rate bases may be summarized as follows:

1	Plant in Service for Gas Operations	$12,977,388
2	Depreciation Reserve	(6,647,680)
3	**Net Plant**	6,329,708
4		
5	**Additions to Rate Base**	
6	Construction Work in Progress without AFUDC	122,893
7	Materials and Supplies & Other Investments	557,591
8	Working Capital Allowance	178,825
9	Total Additions	859,309
10		
11	**Deductions from Rate Base**	
12	Accumulated Deferred Income Taxes	(830,165)
13	Customer Deposits	-
14	Customer Advance for Construction	(68,258)
15	Total Deductions	898,423
16		
17	**Rate Base**	6,290,594

1	Plant in Service for Water Operations	$6,243,258
2	Depreciation Reserve	(917,195)
3	**Net Plant**	5,326,063
4		
5	**Additions to Rate Base**	
6	Construction Work in Progress without AFUDC	415
7	Materials and Supplies & Other Investments	-
8	Working Capital Allowance	23,869
9	Allocation of Rate Base – WPL Contract	-
10	Total Additions	24,284
11		
12	**Deductions from Rate Base**	
13	Accumulated Deferred Income Taxes	(23,828)
14	Customer Advance for Construction	(1,316,179)
15	Customer Deposits	(11,687)
15	Total Deductions	1,351,694
16		
17	**Rate Base**	3,998,653

III. Operation Revenues and Expenses

A. Introduction

Schedules showing the operating revenues, expenses and income at present and recommended rates for the test year ending December 31, 2002, are presented by SBWGE and Staff witnesses. SBWGE accepted all of Staff's proposed adjustments for its water operations. SBWGE also accepted most of Staff's proposed adjustments for its gas operations, however, SBWGE and Staff disagree on the inclusion of Shared Savings Expenses in SBWGE's revenue requirement, as discussed below.

The following adjusted Gas Operating Revenue and Expenses reflects SBWGE's proposed income statement and includes SBWGE's Shared Savings expenses which Staff recommends be excluded from the income statement:

	Gas Income Statement	**SBWGE**
1	Operating Revenues	$ 2,890,324
2	Interdepartmental	36,949
3	PGA Revenues	3,720,805
4	Total Operating Revenues	6,648,078
5	Uncollectible Expense	33,240
6	PGA Cost of Gas	3,720,805
7	Distribution Expense	420,632
8	Customer Accounts	175,926
9	Customer Service and Info	345,716
10	Sales Expense	127
11	Administrative and General	623,084
12	Depreciation and Amortization	408,369
13	Taxes other than income	18,308
14	Total Operating Expense Before Income Taxes	5,746,207
15	State Income Taxes	51,520
16	Federal Income Taxes	228,671
17	Deferred Taxes and ITC net	(2,345)

18 Total Operating Expenses	6,024,053
19 Net operating Income	624,025

The following water income statement incorporates SBWGE's adoption of Staff's recommended adjustments:

Water Income Statement

Sale of Water	896,898
Interdepartmental	710
Water Adjustment Clause Revenues	317,313
Total Operating Revenues	1,214,921
Uncollectible Expense	6,075
Source of Supply	317,313
Transmission/Distribution Expense	59,776
Customer Accounts	25,537
Administrative and General	105,642
Depreciation and Amortization	116,082
Taxes other than income	9,025
Total Operating Expense Before Income Taxes	639,450
State Income Taxes	32,908
Federal Income Taxes	184,986
Deferred Taxes and ITC net	(39,088)
Total Operating Expenses	818,255
Net operating Income	396,666

B. Uncontested Issues

SBWGE did not contest Staff's adjustments (except as noted regarding Shared Savings costs) impacting the SBWGE's requested revenue requirement increases for SBWGE's gas and water utility service. Those adjustments were proposed by Staff Witness Burma C. Jones with respect to Schedules 2.1 Gas &

2.1 Water (Uncollectible Accounts Expense Adjustment); Schedules 2.2 Gas & 2.2 Water (Amortization of Rate Case Expense Adjustment); Schedules 2.3 Gas & 2.3 Water (Taxes Other Than Income Expense Adjustment); Schedule 2.4 Gas (Operation Expense True-up Adjustment); Schedule 2.5 Water (Customer Accounts Expense Adjustment); Schedule 2.5 Gas (PGA Revenue and Cost of Gas Adjustment). (ICC Staff Exhibit 13.0 at 2); (MWS-2 at 2).

SBWGE agreed to Staff's proposed adjustment to increase purchased water revenue as shown on Exhibit 3.0, Schedule 3.2 (Source of Water Revenue Adjustment). (ICC Staff Exhibit 9.0 at 3); (LJW-4 at 3).

Staff agreed to SBWGE's proposal for adoption of a purchased water clause in IL. C. C. No. 8. (ICC Staff Exhibit 9.0 at 4); (MWS-2 at 2).

SBWGE agreed with Staff that no water surcharge should be approved or take effect until the conclusion of these dockets, as initially proposed under Il. C. C. No. 7. (ICC Staff Exhibit 9.0 at 4); (MWS-2 at 2).

SBWGE and Staff's agreement on the adjustments to the income statement do not extend to impacts related to the proposed return on equity level and Commission Staff adjustment to reduce gas customer and information expense by $134,887 for the Shared Savings program costs. ($90,683 of Shared Savings cost amortization on the books and records of SBWGE and $44,204 of Shared Savings costs allocated from WPL to SBWGE based on the approved Contract formulas). (MWS-2 at 2).

C. Contested Issue - Gas - Shared Savings Expenses

a. SBWGE's Position

SBWGE is requesting permission to amortize and recover the deferred Shared Savings customer incentive costs over three years. (SBWGE Exhibit MSW-1(Gas)). SBWGE's total deferred customer incentive costs equal $1,503,025 of which $272,048 has been allocated to gas. The three-year amortization of this amount results in $90,683 per year.

1. Background on Shared Savings Program

Shared Savings is a performance-based demand-side management program offered by SBWGE. Shared Savings is designed to help Illinois businesses make energy saving, cost saving and process improvements with little or no up-front investment of time or money. Shared Savings is available to all retail non-residential customers in Illinois, including retail, small businesses, factories, farms, hospitals, schools and state organizations. The program removes barriers to enable customers to install energy efficient equipment. This direct involvement assists customers who are not able to invest the time necessary to learn about the most efficient technology or to install equipment that achieves energy savings.

Shared Savings was instituted in 1998 as a continuation of SBWGE's 1988 demand-side program. In 1988, the Commission approved the company's Bright Ideas for Business in ICC Docket No. 88-0199. ICC Docket No. 88-0199, October 27, 1988. The Shared Savings Program is similar to the Bright Ideas for Business Program approved by the Commission in 1988, only the name and accounting treatment have changed. Like Shared Savings, Bright Ideas for Business provided energy efficient information and financial assistance to commercial and industrial customers. ICC Docket No. 88-0199 at page 2. In that Order, the Commission approved the implementation of SBWGE's energy conservation programs in its Illinois service territory. (*Id.* at 5).

SBWGE continued its demand-side management program to help non-residential customers overcome hurdles in implementing energy saving projects. SBWGE believes demand-side management programs are effective in managing demand options. It is an important tool in the delivery of energy efficiency to commercial, industrial, and agricultural customers. SBWGE recognized that customers faced several barriers that made it less likely that energy efficiency projects would be initiated absent a formal program. Therefore, SBWGE continued its Bright Ideas for Business in the form of Shared Savings to address the customer barriers of a lack of knowledge, lack of time, lack of capital and risk avoidance.

When it comes to energy efficiency, customers face many barriers in effectively managing their gas usage. Typically, non-residential customers do not have extensive knowledge concerning how their processes, support systems and building systems use energy. Customer personnel do not have the resources to research internal energy utilization, much less all the equipment and vendor claims they receive which promise to save money, improve efficiency or make their jobs easier. They rarely have time to devote to implementing energy saving projects in their facilities. Their efforts are focused on growing their business and on managing their key business processes. (JO-1 at 2).

Moreover, SBWGE's customers lack the capital for these types of projects because the capital for energy efficiency improvements are often difficult to obtain or cannot compete with the capital needs of other revenue producing aspects of a customer's business. (*Id.*) Most corporations allocate capital with financial factors, such as return on investment. Unfortunately, many energy efficiency projects are not perceived to have sufficiently competitive paybacks to be considered for implementation. Also, non-residential customers typically need an additional financial incentive in order to implement an energy efficiency project because of SBWGE's relatively low electric and gas rates. Shared Savings provides an incentive for customers to evaluate equipment and process options based on energy savings over time.

Moreover, since customers have little or no knowledge concerning energy utilization and savings potential concerning their facilities and lack the time to perform the research necessary to identify and quantify energy efficient equipment, they are reluctant to propose projects based on energy savings. (*Id.* at 4-5) They are concerned that the savings may not materialize or that there will be some other negative impact that will reflect poorly on them. Therefore, they avoid these projects because they do not want the risk associated with a problem or no savings.

SBWGE's Shared Savings removes barriers customers face by offering information, the time and money needed to make the improvements and a guarantee of savings through its Shared Savings energy efficiency projects. Additionally, SBWGE provides technical support engineers to provide detailed solutions to customer applications concerning energy efficiency. SBWGE has also established relationships with industry experts and has access to those experts for situations requiring more particular expertise for the specific customer situation. Company personnel also assist with the installation of energy efficient equipment, further reducing the need for customers to devote resources to energy projects.

2. How Shared Savings Works

In order to assist the customers with its energy efficiency projects, SBWGE provides the capital for the projects through its internal sources of funds. The customer typically pays nothing up front and pays back this amount through energy savings. Many customers treat this payment as an operations expense, thereby fully avoiding the capital appropriations issue. Therefore, Shared Savings minimizes the customer's risk because SBWGE guarantees a positive cash flow. There is no risk of a negative cash flow due to implementing any project.

A SBWGE representative analyzes the customer's school, office or plant energy use and presents a plan for making improvements. This up-front approach is important because the SBWGE representative can often find more projects to incorporate into a single contract and identify opportunities for future follow-up. (JO-1 at 6). The SBWGE representative works with the customer to select suppliers and installers, to purchase the equipment and to coordinate the installation of the efficiency measures. SBWGE does not itself provide or install any of the gas efficient equipment. Rather, the customer retains local contractors and suppliers to provide and install the equipment, the customer sends the invoices to SBWGE and SBWGE reimburses the customer for the invoices. (*Id.*) The customer repays SBWGE in monthly payments over three to five years. Many customers find this financing approach to be preferable to an upfront investment, as the Shared Savings Program allows them to treat this as an operating cost, which helps to avoid capital constraints. SBWGE guarantees that the savings in lower gas bills will pay for the improvements. When the payments are complete, the customer retains all the savings associated with the gas efficient equipment for the life of the equipment.

A customer incentive is created when the customers pay back SBWGE the cost of the project plus a small administrative fee. SBWGE uses its normal capital acquisition methods with its weighted cost of capital and provides the customer the incentive of a low cost funding source. SBWGE is requesting the recovery of these customer incentive costs in this proceeding.

3. Request for Recovery

As stated above, SBWGE is requesting permission to amortize and recover the deferred Shared Savings customer incentive costs over three years, the three-year amortization results in recovery of $90,683 per year. On March 24, 1998, Staff sent a letter to SBWGE stating that it agreed with the methodology in which SBWGE would account for its Shared Savings energy efficiency service. (SBWGE Exhibit JO-2 at 4). Staff, however, did state that recognition of the accounting procedures should not be construed as approval of any ratemaking treatment and has not reviewed the program and has not offered an opinion as to the propriety of the Shared Savings program. (*Id.*) SBWGE has established that some Shared Savings expenses were incurred in the test year and that some expenses were known and measurable changes outside of the test year, and as such is requesting a pro forma adjustment for those changes. The propriety of the Shared Savings program is being investigated in this rate case, and SBWGE believes it has established its burden that the costs that it has incurred regarding Shared Saving are just and reasonable.

SBWGE notes that what is absent from Staff's testimony is any evidence that expenses related to the Shared Savings program are unjust and unreasonable. In fact, Staff states in its testimony that SBWGE properly accounted for the expenses of the Shared Savings program. (ICC Staff Exhibit 9.0 at 5). Moreover, Staff's characterization of the Commission's responsibility holds true when evaluating a company's rate of return, but for setting rates, the Commission is obligated to render all rates as just and reasonable. 220 ICLS 5/9-101. Absent a showing the SBWGE's Shared Savings program is unjust and unreasonable, the Commission must reject Staff's recommendation to exclude SBWGE's Shared Savings expenses.

SBWGE further contends that Staff does not offer any testimony that SBWGE's Shared Savings program fails to evaluate demand options in order to determine how SBWGE shall meet its customers' demands for public utility services at the least cost. In fact, Staff does not even address that under the PUA, it is the Commission's objective to ensure that SBWGE consider demand side options. Section 5/1-102 PUA states:

> "[i]t is further declared that the goals and objectives of such regulation shall be to ensure (a) Efficiency: the provision of reliable energy services at the least possible cost to the citizens of the State; in such a manner that: . . . (ii) all supply and demand options are considered and evaluated using comparable terms and methods in order to determine how utilities shall meet their customers' demands for public utility services at the least cost.
>
> (220 ILCS 5/1-102 et seq.)

SBWGE has considered its demand-side options since 1988 and has continued to evaluate and implement those options today, despite the fact that Illinois law no longer requires least cost planning under Section 8-402 of the PUA. However, the repealing of Section 8-402 did not abdicate a utility's responsibility to consider demand-side programs in order to meet their customers' demands for public utility service at least cost under Section 1-102 of the PUA.

SBWGE argues Staff has lost sight of the fact that SBWGE is obligated to evaluate its demand side options under the PUA. SBWGE has evaluated its options under the PUA and has found its Shared Savings to be successful in reducing its gas demand. Furthermore, SBWGE believes its Shared Savings program is an effective tool in managing its peak demand and the Shared Savings program helps SBWGE meet its customers' demand for gas services at the least cost. Shared Savings is a cost of doing business, and as such it is proper for SBWGE to seek recovery. SBWGE established that the costs for the Shared Shaving's program confer a clear benefit to all customers, and therefore on ratepayers.

Furthermore, SBWGE notes that Staff did not dispute the evidence SBWGE presented on its avoided cost model. (JO-3 at 9-11; JO-4) Staff merely found it irrelevant. (ICC Staff Exhibit 9.0 at 5). However, it is the same evidence it presented in Docket No. 88-0199 where the Commission found it to be a reasonable economic analysis for these demand-side programs. (Order at 3 and 4).

SBWGE's analysis of its Shared Savings program using the model found that the societal benefits are over $2.50 for every $1.00 invested. (JO-3 at 9-11;

JO-4). With a benefit-to-cost ratio of 2.5, everyone in SBWGE's Illinois service area receives $2.50 in benefits for every dollar that is invested in the Shared Savings program. From a participant perspective, Shared Savings is estimated to have resulted in nearly $1.6 million in net benefits during 1998-2002, or a benefit-to-cost ratio of 3.24. (JO-4). SBWGE has established that its customers benefited from Shared Savings, and Staff has not established that the costs are unreasonable.

SBWGE further notes Staff contends that the Shared Savings costs must be excluded because they contain some past expenses. (ICC Staff Exhibit 3.0 at 12, ICC Staff Exhibit 9.0 at 6). Staff contends that Commission approval would amount to retroactive ratemaking and single issue ratemaking. (ICC Staff Exhibit 9.0 at 6 and 8). However, Staff does not support its position with facts as to why a pro forma adjustment would trigger retroactive ratemaking or single issue ratemaking. In fact, SBWGE has presented evidence that any deferred balance (debit or credit) is amortized in subsequent test years subject to review within rate proceedings. (MWS-2 at 8; JO-2 at 5). This ensures that there is always a perfect matching of expense and revenue. (*Id.*) Therefore, there is no under or over recovery of the Shared Savings expenses. Consequently, single issue ratemaking is not triggered. Conversely, since no refund is given and no surcharge created, retroactive ratemaking is not triggered.

SBWGE notes that Staff's objections attempt to follow the reasoning the Illinois Supreme Court established in *Illinois Bell Telephone Co. v. Illinois Commerce Comm'n,* (1973), 55 Ill 2d. 461, 303 N.E.2d 364. In that case the Court established that operating costs are recoverable from ratepayers only if the utility demonstrates that the expense provides a direct benefit to customers or to services supplied to customers. *Id*. at 483. Although SBWGE believes it has established that Shared Savings confers benefits on all of its customers, SBWGE also notes that the Illinois Supreme Court later found that the *Illinois Bell* holding does not preclude recovery of legally mandated costs of doing business. *The Citizens Utility Board v. The Illinois Commerce Commission,* 166 Ill. 2d 111, 651 N.E.2d 1089, 1095, 209 Ill. Dec. 641.

In its decision, the Court disagreed with the Citizens Utility Board's narrow view of what types of costs and expenses benefit customers. *Id.* at 1095. The Court agreed with the Commission and the utilities that expenses commonly incurred to comply with the mandate of Federal and State law have historically been recoverable from ratepayers. *Id.* The Court noted, income taxes are a legally mandated cost of doing business and are recoverable from ratepayers as a component of a utility's revenue requirement. Id. at 1095. The payment of taxes can be seen as benefiting the ratepayer, because a public utility must fulfill its tax obligations to remain in business. *Id)*

Similarly, in the case at bar, SBWGE is obligated to consider all supply and demand options under the PUA. Demand side management programs such as SBWGE's Shared Savings are widely accepted by the utility industry and Commissions across the country as demand options. Shared Savings allows SBWGE customers to overcome financial hurdles in acquiring energy efficient equipment and business practices; this in turn keeps SBWGE's demand down. As a result SBWGE is better able to manage its peak demand gas costs and avoids costs it may otherwise expend expanding its system to meet that demand. By implementing demand options, SBWGE has met its customer demand for public utility service at the least cost as mandated by the PUA and in doing so has conferred benefits in the form of savings to its customers.

The Commission allows prudently incurred costs to be recoverable. SBWGE has established its Shared Savings expenses are reasonable and prudently incurred costs. Consequently, Staff's proposal to deny Shared Savings expenses must be rejected.

b. Staff's Position

In the current proceeding Staff witness Smith has recommended that the Commission not allow recovery of the Shared Savings expenses. Staff believes that demand-side energy programs such as Shared Savings only confer benefits to industrial and commercial customers. (ICC Staff Exhibit 3.0 at 11) Staff believes the type of benefit conferred on all customers would be in the form of lower natural gas charges. (*Id.*) Staff believes that SBWGE is asking that the rates of the residential customers be increased for the benefit of selected industrial and commercial customers. (*Id.*) Therefore, Staff concludes, the Shared Savings costs should be excluded because one group of customers is subsidizing the cost savings of selected customers. (*Id.*)

Staff further states that SBWGE properly accounts for the cost. (ICC Staff Exhibit 9.0 at 5). Staff explains that there is no dispute regarding the facts of the Shared Savings program; however, Staff proposed that the cost of the program be excluded from recovery from all SBWGE customers. Instead, Staff proposes that only the participants in the program pay for the Shared Savings expenses.

Staff contends that recovery of previously incurred expenses would in effect create a surcharge rider because previously incurred costs would be compared against future recoveries of Shared Savings costs and then would be adjusted to reflect over or under recovery. Staff believes that rates intended to recover costs of future operations should by definition exclude costs for past operations. Moreover, Staff contends it is unreasonable to expect that all customers should pay the interest cost on behalf of participant customers who buy equipment that saves the participant gas costs.

Staff believes the fact that there might be incidental benefits to all customers is irrelevant to the question of who should pay for the cost of the loans that the Company incurs as a result of the Shared Savings program. Staff contends ratemaking policy requires that the customers who cause the cost should pay. In this case, Staff believes the participants in the program incur the cost of the loans because they want to reduce the amount of gas, and associated gas cost, that they use. Therefore, Staff believes it is reasonable that the participants in the program pay the cost of the loans that provide them with the benefit of reduced gas cost.

d. Commission Conclusion

SBWGE seeks to recover from ratepayers the interest associated with loans SBWGE has given to its non-residential customers in its Shared Savings Program. Shared Savings is a performance-based demand-side management program offered by SBWGE. Shared Savings is designed to help Illinois businesses make energy saving, cost saving and process improvements with little or no up-front investment of time or money.

SBWGE correctly states that the Public Utilities Act (Act) requires that the goals and objectives of regulation is to ensure that utilities consider demand-side options. SBWGE has considered its demand-side options since 1988. Shared Savings is a continuation of SBWGE's 1988 program approved by the Commission. In the Commission Order in Docket No. 88-0199, the Commission intended for SBWGE to recovery prudently incurred costs associated with the program.

Staff recommends that the Commission deny recovery of these demand-side management costs because Staff believes only the participants of the Shared Savings program benefit. Therefore, Staff concludes that only the participants should pay for the program. Staff's position, however, does not consider that the Act mandates that a utility consider its demand-side options. The Commission, therefore, rejects Staff's position.

SBWGE considered its demand-side options, and as an incentive for customers to participate in the program, SBWGE offered to finance customers' installation of energy efficiency equipment through use of the utility's internal funds to promote demand-side options. The customers in the Shared Savings program repaid SBWGE for the entire cost of the equipment with the money they saved on their energy bills, and SBWGE is only asking that the carrying cost representing the interest buy down from those loans be recoverable.

The Commission notes that SBWGE made pro forma adjustments for these expenses because not all Shared Savings contracts were made within the test year. The Commission finds that SBWGE has properly determined the amount of the deferred charges as they occurred, and that the Shared Savings program is reasonable. The Commission accepts SBWGE's three year amortization.

D. Commission Conclusion on Operating Revenues, Expenses and Income.

Giving effect to the adjustment approved above and the rates of return on original cost rate base authorized hereafter in this order, 9.92% for SBWGE's gas operations and 9.92% for its water operations, the Commission concludes that SBWGE's income statements for its gas and water operations for the test year and for purposes of this proceeding are as follows:

Gas Income Statement	SBWGE
1 Operating Revenues	$ 2,890,324
2 Interdepartmental	36,949
3 PGA Revenues	3,720,805
4 Total Operating Revenues	6,648,078
5 Uncollectible Expense	33,240
6 PGA Cost of Gas	3,720,805
7 Distribution Expense	420,632
8 Customer Accounts	175,926
9 Customer Service and Info	345,716
10 Sales Expense	127
11 Administrative and General	623,084
12 Depreciation and Amortization	408,369
13 Taxes other than income	18,308
14 Total Operating Expense Before Income Taxes	5,746,207
15 State Income Taxes	51,520
16 Federal Income Taxes	228,671
17 Deferred Taxes and ITC net	(2,345)
18 Total Operating Expenses	6,024,053
19 Net operating Income	624,025
20 Rate Base	6,290,594
21 Return on net investment rate base	9.92%
22 Net Operating Income	624,027

Water Income Statement

1	Sale of Water	896,898
2	Interdepartmental	710
3	Water Adjustment Clause Revenues	317,313
4	Total Operating Revenues	1,214,921
5	Uncollectible Expense	6,075
6	Source of Supply	317,313
7	Transmission/Distribution Expense	59,776
8	Customer Accounts	25,537
9	Administrative and General	105,642
10	Depreciation and Amortization	116,082
11	Taxes other than income	9,025
12	Total Operating Expense Before Income Taxes	639,450
13	State Income Taxes	32,908
14	Federal Income Taxes	184,986
15	Deferred Taxes and ITC net	(39,088)
16	Total Operating Expenses	818,255
17	Net operating Income	396,666
18	Rate Base	3,998,653
19	Return on net investment rate base	9.92%
20	Net Operating Income	396,666

IV. Cost of Capital/Rate of Return

A. Introduction

The components of capital costs include return on common equity and the costs associated with long term debt and preferred stock. Mr. Enrique Bacalao testified with respect to the rate of return SBWGE should be allowed to earn on common equity in this proceeding. Ms. Janis Freetly, Senior Financial Analyst, presented Staff's analysis of SBWGE's cost of equity and capital structure. SBWGE and Staff agreed upon a capital structure, cost of debt and cost of preferred stock. The only outstanding issue solely lies in assigning proper cost rates to common equity within the agreed capital structures.

B. Capital Structure – Long Term Debt – Preferred Stock

SBWGE proposed using WPL's December 31, 2002 capital structure, and Staff did not object to the use of WPL's capital structure because SBWGE is a direct subsidiary of WPL and obtains all of its capital from WPL. (ICC Staff Exhibit. 4.0 at 4). SBWGE accepted Staff's recommended adoption of WPL's December 31, 2002 capital structure comprised of 2.58% short term debt, 39.73% long term debt, 4.69% preferred stock, and 53% common equity. (ICC Staff Exhibit 4.0 at 4 and Schedule 4.01)

Staff and SBWGE agree on the appropriate respective capital structures as of December 31, 2002, and the embedded costs of debt and preferred stock for SBWGE. (ICC Staff Exhibit 4.0, Schedules 4.02, 4.03, 4.04). The only outstanding issue solely lies in assigning proper costs of common equity within the agreed capital structures.

C. Rate of Return – Cost of Common Equity

1. SBWGE's position

SBWGE Witness, Mr. Bacalao, noted that its common stock is not openly traded in the market, since SBWGE is wholly owned by Wisconsin Power and Light Company ("WPL"). WPL's common stock, in turn, is not openly traded in the market, since WPL is wholly owned by Alliant Energy Corporation ("AEC"). Due to its modest size, SBWGE depends on WPL for its funding, and WPL depends on AEC to obtain additional common equity. In order to estimate SBWGE's cost of common equity, SBWGE's witness, Mr. Bacalao did not rely on AEC's marginal cost of equity. Instead, he created a proxy group of companies comparable to SBWGE and WPL.

On the basis of Mr. Bacalao's studies, he found that the average cost of equity for his proxy companies is equal to 12.71 percent for SBWGE's gas operations and 12.71 percent for its water operations. His conclusions are based on his application of five standard cost of equity estimation techniques: (1) the historical return on equity (ROE) model; (2) the forecasted ROE model; (3) capital asset pricing model (CAPM); (4) the discounted cash flow model (DCF); and (5) risk premium model. (EB-1(Gas) at 15-16; 22-23; EB-1(Water) at 15-16; 23-24).

1. Operational Risks to SBWGE

Mr. Bacalao considered several factors and elements of risks in assessing the required fair return on common equity for SBWGE, including:

- A level of return sufficient to maintain the financial integrity of SBWGE.
- A level of return sufficient to provide a return to shareholders consistent with the returns available from investment alternatives of corresponding risk.
- A level of return sufficient to attract sufficient capital at reasonable costs to support SBWGE's business operations and fulfill its duty to serve the public during both favorable and unfavorable conditions in the capital markets. (EB-1(Gas) at 2-3; EB-1(Water) at 2-3).

In developing a fair rate of return on common equity, Mr. Bacalao reviewed various elements of risk that impact corporations. These risks are typically considered by investors when making investment decisions. The risks include economic risk, industry risk, regulatory risk, market risk and company-specific risk. Investment risk is the summation of economic, industry, regulatory, market, and company-specific risk. The most significant change in these risk factors over the last several years has been the increase in industry risk as a result of utility restructuring. All the foregoing factors impact the stability of the utility business and heighten risk. (EB-1(Gas) at 3; EB-1(Water) at 3). Changes in these factors, as well as the changing nature of the utility industry, have caused all utilities to face more industry risk than they have in the past. As a consequence of this fundamental secular change and of the uncertainties surrounding this secular change, investors will demand a higher return to offset the associated incremental risk.

Mr. Bacalao discussed how specific risks impact SBWGE. All companies face challenges that are unique to them individually and investors consider the company-specific risks associated with SBWGE as they weigh investment alternatives. Company-specific risks associated with SBWGE include:

- the ability to maintain its financial integrity;
- the ability to remain a low cost energy supplier in the face of increasing competition from neighboring utilities and other providers;
- the economic health of its service territory and the role that plays in the demand for the company's products and services;
- equipment failures and accidents;
- the effects of significant variations in weather, and other uncontrollable factors. (EB-1(Gas) at 13: EB-1(Water) at 13).

The economic health of SBWGE's service territory also contributes to SBWGE's company-specific risk. Local economic changes create increased uncertainty of revenues and earnings, in turn increasing SBWGE's risk to the shareholder. (*Id.*) Another set of company-specific risks are those associated with equipment failures and accidents. The potential for equipment failures and accidents is always prevalent, as WPL's facilities are expected to operate in very adverse conditions, including extreme heat and cold, heavy winds and precipitation. Further, WPL's personnel, acting on behalf of SBWGE, are expected to work under these conditions as most outages occur during these periods. (*Id.*) Variations in weather also have a direct impact on SBWGE's company-specific risk. As mentioned earlier, the high degree of variation and unpredictability in heating and cooling degree days in our service territory creates additional uncertainty in revenues and earnings.

2. SBWGE: Measurement of the company's investment risk

For investors in debt securities, one measure of a company's investment risk is its credit rating. Statistical credit rating agencies, notably Moody's Investor's Service ("Moody's") and Standard and Poor's (S&P), rate the chances that specific debt securities might go into default, calibrating those probabilities using a safety ranking system ranging from the high-quality Aaa/AAA+ on down to C-/D, depending upon the investment characteristics of the issuer and the specific provisions of the debt securities being rated. From a bondholder's viewpoint, WPL's (and hence SBWGE's) investment risks are most comparable to other corporations having similar bond ratings. WPL's current ratings, as disclosed in *Bloomberg Professional.* (EB-8).

For investors in common stock, as opposed to investors in debt securities, one measure of a company's investment risk is the price stability of the stock, in addition to its financial strength. A measure of investment risk for common stocks is the Value Line Investment Survey, which assigns a Safety Rank from 1, the highest, to 5, the lowest. Investment risk and credit risk are separate and distinct considerations. The purpose of the Value Line Safety Rank is to measure the risk level of an individual stock, and is based primarily on the Value Line Price Stability Index. The other component of the Safety Rank is that company's financial strength.

In order to estimate SBWGE's, and WPL's, Safety Rank, Mr. Bacalao began by looking at AEC's Safety Rank, which is 2. The next step was to determine what elements would be sufficiently compelling to justify notching SBWGE/WPL up to highest rank (1) or down to the next lowest rank (3). After examining the metrics of companies ranked 1, he concluded there were no compelling reasons to justify an upgrade. Equally, there were no compelling reasons to rank it one notch lower at 3. By this measure, SBWGE/WPL's common equity investment risk is comparable to other companies having a Safety Rank of 2.

As stated above, Mr. Bacalao relied on five models to determine a fair return on equity for SBWGE. For each of these models, he used a sample of comparable companies with an investment risk profile similar to that of WPL, SBWGE's parent. The returns given by these models indicate the approximate returns that investors have achieved and would reasonably expect to achieve on various alternative equity investments.

3. SBWGE's ROE Analysis

Mr. Bacalao testified that in efficient markets, investors expect to earn similar returns on stocks of a similar risk. (EB-1(Gas) at 15; EB-1(Water) at 15). Investors will expect higher returns on stocks with higher risk, and will expect lower returns on stocks with lower risk. In order to make a valid comparison of return on equity in the various models and to avoid making biased estimates of the return on equity, he used a measure of risk needs to selectively screen for companies with similar equity risk profiles.

To make this determination Mr. Bacalao started by looking at all of the companies followed by the Value Line Investment Survey. From the survey, he selected those companies that have a Value Line Safety Rank of 2 and an S&P long-term corporate credit rating similar to that of WPL. When Mr. Bacalao drafted his testimony in October of 2003, WPL had a S&P long-term corporate credit rating of “A-.” The Safety Rank is primarily determined by the Stability Index for the company as well as the company's financial strength. The use of Safety Rank 2 and S&P rating as selection criteria was done in order to select companies with a similar risk profile to that of WPL and SBWGE. The Safety Rank of WPL and SBWGE are not directly observable in the Value Line reports; therefore Mr. Bacalao used the Safety Rank of WPL’s parent, Alliant Energy, as starting point in establishing the equity investment risk of SBWGE as discussed above. The results of the screen of companies with a Safety Rank of 2 and an S&P rating of “A-” are shown in (EB-9). There are 195 companies with a Safety Rank of 2. There are 23 companies that have a Safety Rank of 2 and an S&P rating of “A-.” These 23 companies are used as the comparables for determining the appropriate return on equity estimate for SBWGE. (EB-1(Gas) at 17; EB-1(Water) at 15; (EB-

10)). Of this 23-company sample, those that were missing any relevant data needed for any one of the five models were eliminated from Mr. Bacalao's calculations for that respective model.

a) Historical ROE model.

The historical ROE model shows the actual returns on book equity that were achieved during the period from 1992 to 2001. Analysis of actual book returns instead of market-based returns provides a less biased view of return levels given the rapid increase in stock market valuations during recent years. Mr. Bacalao took the historical ROE's from the Value Line Reports for each company in the sample. Mr. Bacalao then determined the average annual ROE of the companies ranged from a low of 13.17% in 1995 to a high of 16.44% in 2000. (EB-1(Gas) at 18; EB-1(Water) at 18). Finally, the average ROE over the period 1992 to 2001 for the sample companies was 14.02%. (EB-1(Gas) at 17-18; EB-1(Water) at 17-18; (EB-11)).

b) Forecasted ROE Model

The forecasted ROE model shows the forecasted returns on book equity from 2002 to 2007. Again, an analysis of forecasted book returns was used instead of forecasted market based returns for the same reasons as given for the historical ROE model. In addition, looking at historical and forecasted book ROE's enhances comparability between the returns of these two models. Mr. Bacalao derived the ROE forecasts from Value Line estimates and Value Line Reports for each company in the sample. Mr. Bacalao determined that the average annual forecasted ROE of the companies ranged from a low of 13.24% in 2002 to a high of 14.05% in 2005-2007. ((EB-1(Gas) at 18; EB-1(Water) at 18). The midpoint estimate is 13.85%. (*Id.*).

c) CAPM

Mr. Bacalao used the following formula to calculate the expected returns on equity using the CAPM:

$$R_e = r_f + \text{Beta X } (r_m - r_f)$$

where:

R_e = expected return on stock

r_f = risk-free rate

r_m = expected market return

(EB-1(Gas) at 19; EB-1(Water) at 19).

For each company in the sample, Mr. Bacalao listed the levered betas provided by the Value Line Reports. Since the companies in the sample have a different leverage, their betas as shown in Value Line are not comparable. To make them comparable, Mr. Bacalao took the levered betas, un-levered them, and then re-levered them based on the estimated leverage of WPL. The book equity of Alliant Energy Corporation and WPL, in connection with the market to book equity ratio of Alliant Energy Corporation equity, were used to calculate an approximate equity market capitalization for WPL since WPL does not have a publicly traded stock. ((EB-1(Gas) at 19; EB-1(Water) at 19; (EB-14)). The formula showing the relationship between a levered and un-levered Beta was taken from Ibbotson

Associates Cost of Capital Quarterly Yearbook for 1999. (EB-1(Gas) at 19; EB-1(Water) at 20).

The average re-levered beta of the sample is 0.94, which implies that if these companies had a leverage similar to that of WPL, they would have a market risk slightly less than that of the market portfolio. There are two calculations of the CAPM shown. These calculations are based on the assumed risk-free rate, the expected market return, the equity risk premium, and the calculated average re-levered beta of 0.94. The purpose of using these two calculations is to show that there is a consistent range for the estimated cost of equity.

Mr. Bacalao's first CAPM calculation used the expected 2004, 30-year t-bond yield of 5.70% as an estimate of the risk-free rate. (EB-1(Gas) at 19; EB-1(Water) at 20;(EB-2)). Mr. Bacalao's calculation revealed an expected market return of 12.70% based on the arithmetic mean return of the Large Company Stocks. (EB-16). Mr. Bacalao determined his first CAPM calculation yielded an expected cost of equity of 12.27%. (EB-1(Gas) at 19; EB-1(Water) at 20).

Mr. Bacalao's second CAPM calculation used the expected 2004, 30-year t-bond yield of 5.70% as an estimate of the risk-free rate. (EB-1(Gas) at 20; EB-1(Water) at 20; (EB-2)). The equity risk premium of 7.4% is the long horizon expected equity risk premium for large company stocks. (EB-17). Mr. Bacalao determined that his second CAPM calculation yielded an expected cost of equity of 12.65%.

Mr. Bacalao then determined that the average cost of equity of calculation 1 and 2 is 12.46%. (EB-1(Gas) at 20; EB-1(Water) at 20).

d) DCF Model

The DCF model is a two-stage model that uses forecasted dividends based on analysts' five-year annual growth estimates from Zach's Investment Research and a terminal annual growth rate of 7.979% that represents the long-run nominal GDP growth rate of the economy. Historical nominal GDP growth rates of the U.S. economy, as provided on the International Monetary Fund web site's World Economic Outlook Database. (EB-1(Gas) at 20; EB-1(Water) at 20; (EB-19; EB-20; EB-21)).

Mr. Bacalao used the following formula to determine the expected returns on equity using the DCF:

$$P_0 = [D_1/(1+r)^1] + [D_2/(1+r)^2] + [D_3/(1+r)^3] + [D_4/(1+r)^4] + [(D_5+P_5)/(1+r)^5]$$

where:

P_0 = stock price as of 2/14/2003

$P_5 = [(1+g_1) X D_5]/(r-g_2)$

r = cost of equity

g_1 = analysts' annual 5-year growth rate

g_2 = terminal growth rate

D_0 = actual 2002 dividends per share

$D_1 = D_0 X (1+g_1)$

D_1 = estimated 2003 dividends per share

$D_2 = D_1 \text{ X } (1+g_1)$

D_2 = estimated 2004 dividends per share

$D_3 = D_2 \text{ X } (1+g_1)$

D_3 = estimated 2005 dividends per share

$D_4 = D_3 \text{ X } (1+g_1)$

D_4 = estimated 2006 dividends per share

$D_5 = D_4 \text{ X } (1+g_1)$

D_5 = estimated 2007 dividends per share

The DCF model calculations are shown in (EB-18).

The average cost of equity using the DCF model is 12.32%. (EB-1(Gas) at 21; EB-1(Water) at 22)

e) Risk Premium Model

The risk premium model calculates a cost of equity based on a risk-free rate and the equity risk premium. In this calculation, three investment horizons are used: long, intermediate, and short. The risk-free rate and the equity risk premium can differ depending on which horizon is used, so for comparison purposes, all three horizons are shown in the calculations. In the long-horizon calculation, the 2004 expected 30-year Treasury bond yield of 5.70% is used to represent the risk-free rate. In the intermediate-horizon calculation, the 10-year Treasury bond yield of 4.95% is used to represent the risk-free rate. In the short-horizon calculation, the 1-year Treasury bill yield of 2.70% is used to represent the risk-free rate. The long, intermediate, and short-horizon expected equity risk premia of 7.4%, 7.8%, and

8.8%, respectively, are taken from Ibbotson Associates SBBI. (EB-17). The expected return on equity estimates calculated under this model range from 11.50% to 13.10% and average 12.45%.

Expected return on equity using the Risk Premium model is based on the following formula:

$$r_e = r_f + p$$

where:

r_e = expected return on equity

r_f = risk-free rate

p = equity risk premium

The Equity Risk Premium model calculations are shown in Exhibit___(EB-22).

Mr. Bacalao's results using the Risk Premium model yielded an expected return on equity estimates ranging from 11.50% to 13.10% and average 12.45%. (EB-1(Gas) at 22; EB-1(Water) at 23)

f) Conclusion

Mr. Bacalao made two mid-point cost of equity estimates and a summary cost of equity estimate from the five models in his analysis. His first estimate of 12.41% consists of an average of the CAPM, DCF, and Risk Premium models. His second estimate of 13.02% consists of the average of all five models; historical ROE, forecasted ROE, CAPM, DCF, and Risk Premium. Mr. Bacalao them determined that these two mid-point estimates shown in the first table below, serve as the lower and upper range for the cost of equity summary estimate in the second table immediately following it. The mid-point cost of equity summary estimate (average of 12.41% and 13.02%) is 12.71%. (EB-1(Gas) at 23-24; EB-1(Water) at 23-24).

Based on his analysis, Mr. Bacalao recommended recommend a cost of equity of 12.71% for both SBWGE's gas and water operations.

4. Staff's Measurement of Investment Risk

SBWGE notes that Staff's analysis did not include any of the economic, market or regulatory risks impacting on SBWGE or on its parent WPL. Instead Staff relied only on debt credit ratings as a measure of equity investment risk. As stated above, for investors in debt securities, one measure of a company's investment risk is its credit rating. However, equity investment risk and credit risk are distinct measures, and Staff fails to make this distinction clear in its testimony.

5. Staff's Position

Staff witness Freetly's recommendation for return on common equity for SBWGE's gas operations is 9.87 percent and 9.64 percent for its water operations. (ICC Staff Exhibit 4.0 at 32). She based her recommendations on two estimation techniques: the DCF and CAPM. (ICC Staff Exhibit 4.0 at 12). Staff then applied both models to samples of natural gas distribution companies, water utilities and public utilities comparable to WPL, since SBWGE does not have market-traded common stock. (*Id.* at 13.)

Ms. Freetly noted that “an obligor rated ‘A’ has a strong capacity to meet its financial obligations, but is somewhat more susceptible to adverse effects of changes in circumstances and economic conditions that obligators of higher rating categories.” (ICC Staff Exhibit 4.0 at 9) Ms. Freetly did not recognize that WPL is more susceptible to adverse effects of changes in circumstances and economic conditions than those companies in her proxy with higher credit ratings and did not recognize or correct this distortion.

Staff used a higher, less risky debt ratings in its proxy groups because Staff contends Section 9-230 prohibits the Commission from reflecting an increased cost of capital in the rate of return as a direct or indirect result of a utility’s affiliation with an unregulated company. (ICC Staff Exhibit 4.0 at 9-10) Therefore, Staff concludes it would be inappropriate to base SBWGE’s allowed rate of return on the basis of WPL’s A- credit rating since that credit rating is due to its affiliation with unregulated or non-utility companies. (*Id*. at 10.)

Ms. Freetly chose to apply the single-stage discounted cash flow (“DCF”) model and the capital asset pricing single-factor risk premium (“CAPM”) model without expressly noting their respective limitations or identifying the characteristics of the alternative variations of these two particular models.

Staff’s proxy samples for both SBGWE’s gas and water operations contained companies that had a less risky business profile than SBWGE. Staff Ex. 4, Schedule 4.10 demonstrates that her proxy groups contained higher rated (less risky) credit ratings than WPL’s, as well as lower risk in operations, as demonstrated in lower business profiles scores, than WPL. (Staff Ex. Tr. 203-206)

On cross-examination, Ms. Freetly admitted that the proxy group should reflect the business risk of SBWGE. (Tr. at 203-204)

Ms. Freetly determined her average investor required rate of return on common equity for the gas operations based on the average of her DCF-derived results (9.40%) and the risk premium-derived results (10.32%), for her gas sample.

Ms. Freetly estimated the investor-required rate of return on common equity for the water operations by first averaging the DCF-derived estimates of the required rate of return on common equity for the water (9.78%) and utility (8.98%) samples, or 9.38%, then, second, averaging the risk premium-derived estimates of the required rate of return on common equity for the water (9.40) and utility (10.10%) samples or 9.90%, and then lastly, taking the midpoint of the DCF and risk premium derived estimates, which equals 9.64%.

Ms. Freetly averaged the results of the utility sample with the water and not that gas sample because the gas, water and utility samples serve as proxies for the target company and should therefore reflect the risk of that company. Ms. Freetly found that in forming the water sample, several of the companies did not have S&P credit ratings or business profile scores. Hence, she developed another sample based on credit rating and business profile scores for risk comparability for the water operations. Since the utility sample was similar to the gas sample, Ms. Freetly believed that averaging the cost of equity estimates for those two samples would result in giving double-weight to those duplicative companies.

Additionally, Ms. Freetly noted that the S&P benchmark ratios, namely pre-tax coverage, funds from operations interest coverage, total debt to capital, and funds from operations to average total debt, for each on the samples in comparison to WPL. Ms. Freetly took these ratios from the *S&P Utility Compustat* database. Ms. Freetly found that the three-year average benchmark ratios for the gas sample are the most similar to WPL. The three year average benchmark ratios for the utility sample are more comparable to WPL than the water sample. Hence, Ms. Freetly used the utility sample in conjunction with the water sample to estimate the cost of equity for the water operations of SBWGE to more closely simulate the risk of WPL. Ms. Freetly retained the water sample because it captured industry-level operating risks associated with the provision of water service. Ms. Freetly believed it was not necessary to use the utility sample in combination with the gas sample because the three-year average bench mark ratios for the gas sample were more comparable to WPL than the utility sample and reflected what she believed was the risk of WPL.

D. Commission Conclusion

Based upon our review of the record, we conclude that SBWGE's analysis of the cost of common equity is more appropriate. There are several major differences between the approaches of Mr. Bacalao and Ms. Freetly. First, Mr. Bacalao uses five models to calculate his cost of equity estimates where as Ms. Freetly uses only two. While the Commission has generally accepted these two models in the past, the Commission cannot relay on Ms. Freetly's assumptions used in those two models because they greatly under estimate the cost of equity for SBWGE.

Second, by limiting her analysis to only two models, Ms. Freetly could not compensate for the short comings of those two models. Ms. Freetly's proxy group had an average business profile of 3, whereas, SBWGE's parent company, WPL, had a business profile of 4. Ms. Freetly did not make any upward adjustments for this discrepancy. This is inconsistent with our previous finding in Docket 02-0798, 03-0008, and 03-0009 (consol.) wherein we made a downward adjustment to AmerenUnion Electric's cost of common equity because the gas sample was more risky than AmerenUnion Electric's gas distribution in terms of financial strength. Equally, the Commission cannot accept Ms. Freetly's gas and water sample's because she failed to upward adjust her recommendations for SBWGE's cost of equity on its gas and water operations despite the increased risk in business operations. Ms. Freetly's proxy groups do not adequately reflect the risks associated wit SBWGE's businesses, where Mr. Bacalao's proxy groups do.

Third, Ms. Freetly used betas that underestimated company risks, where Mr. Bacalao re-leveraged his betas to reflect the increased company risk. The Commission notes that the U.S. Supreme Court decision in Bluefield Water Works & Improvement Co. v. Public Services Commission of West Virginia, 262 U.S. 679 (1923), found that "a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attend by corresponding risks and uncertainties." The Commission believes that the application of this principle recognizes that utilities are competing for capital not only with other firms in the same line of business, but they are also competing for capital with firms that operate in different types of businesses. To ensure that the returns available to utilities are indeed commensurate with those available on other investments of comparable risk, the return on common equity needs to be measured by reference to firms outside the utility industry. The Commission finds that Staff's analysis does not properly apply the principles outlined by the U.S. Supreme Court, and its failure to do so, greatly underestimates SBWGE's fair rate of return. Mr. Bacalao's analysis, however, recognizes the principle and properly includes SBWGE's company specific risks in his analysis thereby adequately estimating SBWGE's cost of common equity.

Based on the foregoing, we determine that the appropriate cost of common equity is 12.71% for both SBWGE's gas and water operations. This results in an overall rate of return of 9.92% as shown below:

Capital Component	Percent of Total	Cost	Weighted Cost
Short term debt	2.58%	1.00%	0.03%
Long term debt	39.73%	7.30%	2.90%
Preferred stock	4.69%	5.50%	0.26%
Common Equity	53.00%	12.71%	6.74%
Total	100.00%		9.92%

V. Cost of Service Study (COSS)

A. Introduction

SBWGE performed COSS studies for both its gas and water operations in the proceeding. Generally, a COSS is performed to allocate costs among all customer classes by determining each customer class' respective cost responsibility for the costs imposed on the utility by that specific customer class. Rates can then be designed to reflect the cost to serve each customer class.

B. Uncontested Issues

Mr. Larry White performed a COSS for SBWGE's water operations. (LJW-1 and corresponding schedules.) Staff did not object to SBWGE's COSS.

Ms. Sonya Kessinger performed the cost of service studies for the SBWGE gas operations. Ms. Cheri L. Harden testified that Ms. Kessinger COSS allocators are appropriate for designing gas rates and are the same allocators Staff would use in its COSS except for one specific allocator. (ICC Staff Exhibit No. 5.0 at 3) Ms. Harden recommended that SBWGE utilize the average and excess (A&E) allocator, and proposed new rates. (*Id.* at 6)

SBWGE did propose new rates based on using the A&E allocator as recommended by staff. (SMK-4, pages 2-4 and corresponding schedules)

C. Commission Conclusion

The Commission accepts SBWGE's COSS study for its water operations and accepts SBWGE's modified COSS that used the A&E allocator as recommended by Staff. Accordingly, SBWGE's rates will be designed using the results of the above mentioned COSS.

VI. Rate Design

A. Introduction

SBWGE and Staff agree on most issues regarding rate design and tariff terms and conditions in this proceeding. SBWGE has agreed to make changes to its rate design and tariffs as Staff recommended for its gas and water operations, except for Staff Witness Harden's recommendation regarding the Gg-2 customer class for SBWGE's gas rates. (ICC Staff Exhibit 5.0 at 7 and ICC Staff Exhibit 11.0 at 1-2).

It is important to note that for the rate design, SBWGE and Staff used different revenue requirements. The difference between these revenue requirements is substantial and is a significant component in the resulting rates.

B. Uncontested Issues

SBWGE has adopted Staff's recommended approval of the revision to service lateral costs as shown in the tariff. SBWGE proposed increasing the charge for Plastic 1 inch or less service pipe from a $2.50 incremental charge per foot to $3.65; increasing the charge for Plastic 2 inch service pipe from a $3.65 incremental charge per foot to $6.25; and adding a Steel 2 inch service pipe with a charge of $9.80 per incremental foot. Staff has reviewed SBWGE's proposal and supporting documentation supplied (confidentially) in response to DR CLH-8, and has found the service lateral costs to be reasonable. (ICC Staff Exhibit 11.0 at 2).

During the hearing, Staff Witness Marr's testified that there are no disputes between Staff and SBWGE regarding the specific issues he raised in his testimony. (Tr. at 167) Those issues include: SBWGE's proposed Final Water Tariff. (ICC Staff Exhibit 12.0 at 2); and SBWGE's "Free Limit" definition now complies with the current provisions of the Commissions' Regulations at §600.370(b)(2). (*Id*. at 3). Mr. Marr recommended SBWGE make additional changes in his Rebuttal Testimony and SBWGE made those changes. (LJW-3, and corresponding schedules.)

C. Contested Issue

While SBWGE and Staff also agree that rates should be cost based, there remains one issue for rate design concerning the Gg-2 large Service Customers for the gas operations.

1. SBWGE's position

Staff recommends that the Gg-2 Large Service customer class rates not change from the existing tariff, and SBWGE recommends that the Gg-2 class be given a portion of the rate increase so that the rate increase appears to be fair to all customers. SBWGE proposes a small increase of ten percent on margin to this class which is captured in the volumetric rate component. (SMK-4 at 4) This increase is very slight resulting in only a two percent increase to the average monthly bill for this class including gas costs as shown in SMK-4, Exhibit___(SMK-2.1), Schedule E-6, page 2 of 3.

SBWGE believes that the move to cost based rates should be done gradually and should address the perception of fair treatment. SBWGE believe it is reasonable to allocate costs so that all classes are asked to shoulder some of the burden of a rate increase. By proposing a much smaller increase to the Gg-2 class, rates move closer to cost-based and this component slightly mitigates the increase to the other classes. SBWGE's proposal is reasonable and consistent with the Commission's goal of setting rates based on cost of service.

2. Staff's Position

Staff recommended that the Gg-2 Large Service customer class rates should not change from the existing tariff. Staff contends that a review of SBWGE Exhibit SMK-3.1, WPE-2, reveals that the Gg-2 class has been over-earning, thereby subsidizing the Gg-1 and Gg-7 customer classes. (ICC Staff Exhibit 5.0 at 8 and ICC Staff Exhibit 11.0 at 1-2). Furthermore, Staff argues that rates for this class should not be increased since this class is already paying significantly more than the proposed rate of return. Staff believes no increase is appropriate at this time.

D. Commission Conclusion

The Commission shares Staff concern that the Gg-2 customer class may be over earning compared to the Gg-1 and Gg-7 customer classes. An eighteen year lag between rate cases, however, will create rate shock if cost based adjustments are not phased in. After reviewing the arguments, the Commission finds that to avoid rate shock, it will accept SBWGE's proposal to allocate a small increase to the Gg-2 Large Service Customer. With smaller increase to the Gg-2 class, rates move closer to cost-based and this component slightly mitigates the increase to the other classes. The Commission will re-examine this issue in future rate cases to ensure all customer classes are moving closer to cost-based rates.

VII. FINDINGS AND ORDERING PARAGRAPHS:

The Commission, having reviewed the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) South Beloit Water, Gas and Electric Company is an Illinois corporation engaged in the storage, transmission, distribution and sale of natural gas and water at retail in Illinois and as such is a pubic utility within the meaning of the Public Utilities Act;

(2) the Commission has jurisdiction of the parties and the subject matter herein;

(3) the findings and conclusions stated in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact;

(4) the test year for the determination of the rates herein found to be just and reasonable is the historical test year ending December 31, 2002; such test year is appropriate for purposes of this proceeding;

(5) for purposes of this proceeding, South Beloit Water, Gas and Electric Company net original cost of gas rate base is $6,290,594; and water rate base is $3,998,653;

(6) a just and reasonable rate of return which South Beloit Water, Gas and Electric Company should be allowed to earn on its net original cost gas and water rate base is 9.92%; this rate of return incorporates a rate of return on common equity of 12.71%;

(7) the rates of return set forth in Finding (6) hereinabove result in gas operating income of $624,027 and water operating income of $396,666;

(8) South Beloit Water, Gas and Electric Company's rates which are presently in effect for its gas and water operations are insufficient to generate the operating income necessary to permit South Beloit Water, Gas and Electric Company the opportunity to earn a fair and reasonable rate of return on net original cost rate base; these rates should be permanently canceled and annulled;

(9) the rates proposed by South Beloit Water, Gas and Electric Company for its gas and water operations will produce a rate of return in excess of a return that is fair and reasonable;

(10) by South Beloit Water, Gas and Electric Company should be directed to file revised rate schedules for gas and water service to produce an increase in annual revenues of $560,490; and water annual revenues of $755,002, based on the test year and inclusion of water surcharge herein approved; with such tariff sheets to be applicable to service furnished on and after their effect date;

(11) the water surcharge is herein approved;

(12) the interclass revenue allocation, rate design, and tariff terms and conditions discussed and accepted in the prefatory portion of this

Order are just and reasonable for purposes of this proceeding and should be accepted;

(13) the new tariff sheets authorized to be filed by this Order should reflect an effective date not less than two working days after the date of filing, with the tariff sheets to be corrected within the time period if necessary;

(14) all objections, petitions or motions in the proceeding which remain undisposed should be disposed of in a manner consistent with the ultimate conclusions contained in this Order.

IT IS THEREFORE ORDERED that South Beloit Water Gas and Electric Company's presently effective schedules containing rates, rules and regulations for gas and water service which are to be replaced by the schedules approved in this proceeding be permanently canceled and annulled, effective upon the effective date of the schedules approved in this order.

IT IS FURTHER ORDERED that the gas and water tariff sheets filed by South Beloit Water Gas and Electric Company be, and are hereby, permanently canceled and annulled.

IT IS FURTHER ORDERED that the original cost of gas plant at December 31, 2002, as reflected on Company Ex. MWS-1 Gas, Schedule B-2, line 10, column (G) of $11,192,009 is unconditionally approved as the original cost of gas plant for consideration of 83 Ill. Adm. 510.

IT IS FURTHER ORDERED that the original cost of water plant at December 31, 2002, as reflected on Company Ex. MSW-1 Water, Schedule B-2, line 15, column (G) of $6,088,177 is unconditionally approved as the original cost of water plant for consideration of 83 Ill. Adm. Code 615.

IT IS FURTHER ORDERED that South Beloit be, and it is hereby, ordered to file new tariff sheets for gas and water service in accordance with Findings (10), (11), (12), and (13) of this order to become effective five (5) days from the date of filing.

IT IS FURTHER ORDERED that with respect to the schedules for rate, rules and regulations for gas and water service filed by South Beloit Water Gas and Electric Company shall become effective upon entry of this order.

IT IS FURTHER ORDERED that any objections, petitions or motions in the proceeding which remain undisposed are hereby disposed of consistent with the ultimate conclusions herein contained.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the public Utilities Act and 83 Ill. Adm. Code Section 200.800, this Order is final; it is not subject to Administrative Law Review.

By order of the Commission this day of September, 2004.

Chairman